IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED SIGNAL, INC., as successor-in-interest to The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ Of Certiorari To The Supreme Court Of New Jersey

BRIEF OF THE STATES OF CONNECTICUT, IOWA, MARYLAND, MASSACHUSETTS, MINNESOTA, PENNSYLVANIA AND RHODE ISLAND AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

On March 11, 1992, this Court requested the parties and invited *amici curiae* to simultaneously file briefs addressing the following questions:

1. Should the Court overrule *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982)?

2. If *ASARCO* and *Woolworth* were overruled, should the decision apply retroactively?

3. If this Court overrules *ASARCO* and *Woolworth*, what constitutional principles should govern state taxation of corporations doing business in several states?

This brief addresses the third question set forth above.

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BRIEF OF THE STATES OF CONNECTICUT, IOWA, MARYLAND, MASSACHUSETTS, MINNESOTA, PENNSYLVANIA AND RHODE ISLAND AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

Pursuant to Sup.Ct.R. 37, the signatory states respectfully submit this brief as *amici curiae* in support of Respondent. Because this brief is sponsored and filed by the aforementioned states, consent to its filing is not required. Sup.Ct.R. 37.5.

INTEREST OF *AMICI CURIAE* AND SUMMARY OF ARGUMENT

The question that this brief addresses raises important issues concerning the allocation of the states'

fundamental power to tax income from intangibles held by corporations that exercise the substantial privilege of carrying on business in more than one state.[1] Under the "unitary business principle," each state in which a corporation operates has the right to tax on a fairly apportioned basis the corporation's entire net income from unitary business activities. This principle defines the scope of the states' authority to tax corporations operating in more than one state and, therefore, affects the manner in which *Amici* impose apportioned income taxes based on formulas measuring in-state corporate activities.

This Court's decisions in *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), illustrate the shortcomings of the unitary business principle with respect to "non-unitary business" income. In allowing a corporation to exclude such income from its apportionable income base notwithstanding that corporation's substantial nexus with the taxing state, these cases assume that the Constitution requires the states to specifically connect each item of income to the corporation's intrastate activities. That requirement is constitutionally unsound and economically unrealistic, is unnecessarily

[1] In the interest of judicial economy, *Amici* address only the third question set forth in this Court's March 11, 1992 Order. *Amici* support and adopt the arguments of *amicus* California urging the Court to overrule its decisions in *ASARCO* and *Woolworth*. *Amici* also support and adopt the arguments of *amicus* Virginia urging that the principles of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), be retained to determine whether a decision overruling *ASARCO* and *Woolworth* should apply retroactively; those principles dictate that such a decision should be retroactive.

complex to administer, and enables corporations to escape their full obligation to pay for protections, opportunities and benefits received in all states in which they operate.

The Constitution conditions a state's power of taxation only on the existence of a minimal connection or nexus between that state and a corporation's interstate activities. If that requirement is met, a state should be allowed to tax that corporation's entire income, provided that the resulting tax is reasonably related to the business transacted in that state. This approach offers a bright-line test that greatly simplifies the ultimate question of defining the taxable income base; eliminates the complex factual inquiries that must presently be made under the unitary business principle; and harmonizes tax consequences by treating in the same manner differing categories of income which are constitutionally and economically indistinguishable.

Amici's position is, in its most basic formulation, that income is income and that it matters neither in a constitutional nor an economic sense whether that income is produced by the sale of a product, by the licensing of technology that enables another entity to sell that product, by the investment of the income generated by those selling or licensing activities, or by the gain on the sale of the investment. *Amici* urge adoption of a rule of full apportionment of all corporate income subject only to the constitutional requirement that there exist both a minimal connection between the taxing state and a corporation's activities within that state and a rational relationship between

the income attributed to the taxing state and the intrastate values of the corporation.[2]

ARGUMENT

I. THE UNITARY BUSINESS PRINCIPLE SHOULD BE MODIFIED.

The unitary business principle is a federal judicial concept initially applied to sustain apportioned state taxation of interstate railroad property. The concept was later extended to state corporate income taxes where it has been used for two distinct purposes: (1) to measure the entire net income of a single corporation from all activities deemed to constitute a part of a single unitary business enterprise; and (2) to combine the income of two or more separate corporations deemed to constitute a single business enterprise. *See U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 n. 25 (1978).

The unitary business principle was originally designed to respond to the difficulty inherent in identifying the geographic source of the income earned

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[2] Maryland law, for example, provides for full apportionment subject to the limitations set forth above. Rental income from real and personal property and capital gain income from sales of real and personal property are now included within the taxable income base of a corporation doing business in Maryland, while previously that income was removed from the corporation's base if the property in question had a situs in another state. Similarly, capital gain income from the sale of intangibles is included within the corporate taxable base whereas previously that income was excluded if the corporation had a commercial domicile in another state. *See* 1987 Laws of Maryland, Ch. 718; Md. Ann. Code Art. 81, § 316(a), (b) (1986 Cum. Supp.) (repealed).

by a multistate enterprise. *See Trinova Corp. v. Michigan Department of Treasury,* ___ U.S. ___, 111 S.Ct. 818, 829 (1991). Factors contributing to this difficulty include functional integration, centralization of management and economies of scale. *Id.* at 832. Courts have accordingly developed the unitary business principle which

> rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 165 (1983).

Under the unitary business principle, as currently understood by the Court, the fact that the source of particular income may be ascertained by separate geographical accounting is constitutionally irrelevant. As long as the income-producing activity is part of a unitary business, the income is includable in the apportionable income base. *See Trinova,* 111 S.Ct. at 831; *Amerada Hess Corp. v. Director,* 490 U.S. 66, 73 (1989) (fact that activity occurring entirely outside the state is conducted by a unitary business subjects resulting income to taxation). So stated, and as so limited, the principle is a sound and workable one.

In *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Dept.*, 458 U.S. 354 (1982), however, this Court expanded the principle to remove income from intangibles from the corporations' apportionable income base because it found no unitary business relationship between the income-payors and the income-recipients. For the reasons stated below, that expansion of the principle demands more than the Constitution requires, ignores economic realities, and virtually assures that a significant portion of a corporation's income will not be taxed by the states even though that corporation receives benefits in each state in which the corporation conducts its business.

This Court has never suggested that a purchaser of a product must be unitary with the seller for a state to tax income from that sale. There should similarly be no restrictive unitary requirement for other types of income. As long as a state has a minimum connection or nexus with a corporation's interstate activities, that state should be permitted to fairly apportion all of that corporation's income. *Amici* urge that the unitary business principle be modified to focus solely on the activities of the taxpayer and not on the identities or activities of those who pay the taxpayer income.

II. ALL INCOME OF A CORPORATION DOING BUSINESS IN A STATE SHOULD BE SUBJECT TO APPORTIONMENT.

A. The Linchpin Of Fair Apportionability Is Nexus.

This Court has recognized that the "entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas uti-

lizing in-state aspects of interstate affairs." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 460 (1959). The states' ability to apportion that income hinges on whether there exists "a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 436-37 (1980).

The unitary business principle should not, however, be "the linchpin of apportionability for state income taxation of an interstate enterprise. . . ." *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. at 362, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207, 223 (1980), in turn quoting *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 439. Rather, as long as "the tax is fairly apportioned to the commerce carried on within the State," "the only question is whether the tax in practical operation has relation to opportunities, benefits, or protection conferred or afforded by the taxing State." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317, 325 n. 5 (1968). The linchpin of fair apportionability, therefore, is the " 'nexus' between the interstate activities and the taxing State. . . ." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 165-66, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. at 219-20.

Absent that nexus, a state has no right to apportion any income. " 'Taxable event', 'jurisdiction to tax', 'business situs', 'extraterritoriality', are all compendious ways of implying the impotence of state power

because state power has nothing on which to operate." *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). "And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.' " *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967), quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444. Similarly, "the Court has held that 'State taxation falling on interstate commerce * * * can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys.' " *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. at 756, quoting *Freeman v. Hewit*, 329 U.S. 249, 253 (1946).

Under either the Due Process Clause or the Commerce Clause, however, if a state has established "some definite link, some minimum connection, between [that] state and the person, property or transaction it seeks to tax," *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954), that state has the power to tax "the *entire* net income of a corporation. . . ." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. at 460 (emphasis added).

Of course, "the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.' " *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978), quoting *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 325. The Constitution thus proscribes a state's attempt to levy a tax that is "out of all appropriate proportion to the business transacted . . . in that state." *Hans Rees' Sons, Inc. v.*

North Carolina ex rel. Maxwell, 283 U.S. 123, 135 (1931).

But it is the method used in apportioning that income and levying that tax, and not the unitary business principle, that ensures that a tax has not "resulted in such gross overreaching . . . as to violate the Due Process and Commerce Clauses of the Constitution." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 326. *See also Shell Oil Co. v. Dept. of Revenue*, 488 U.S. 19, 30-31 (1988) (mere inclusion of income in preapportioned tax base does not establish extraterritorial taxation). As far as a state's power of taxation is concerned, once "[t]he requisite 'nexus' is supplied if the corporation avails itself of the 'substantial privilege of carrying on business' within the State . . . '[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction.' " *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 437, quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444-45. There is, and should be, *no* nexus requirement with respect to a particular transaction, such as a sale of stock; the Constitution is satisfied by the demonstrated nexus of the taxpayer to the taxing state. *See National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560 (1977) ("The Society argues in other words that there must exist a nexus or relationship not only between the seller and the taxing State, but also between the activity of the seller sought to be taxed and the seller's activity within the State. We disagree.").

B. The Constitution Does Not Require The Piecemeal Exclusion Of Income From A Corporation's Apportionable Income Base.

Once a nexus exists between a corporation and the taxing state, no constitutional purpose is served in allowing that corporation to specifically exclude from its apportionable income base on an itemized basis dividends, capital gains or other types of income allegedly unrelated to the corporation's presence in the taxing state. To the contrary, the Constitution requires only that an *estimate* of a corporation's business be attributed to the taxing state and that a fairly designed apportionment formula be utilized to assure that there is a *reasonable* relationship between the income to be taxed and the in-state values of the taxpayer.[3] Permitting a corporation to exclude income

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[3] In confirming the inexact science of imposing a tax on "[t]he substantial privilege of carrying on business," *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444-45, this Court has recognized the "impossibility" inherent in any attempt to mathematically calculate income attributable to intrastate activities: "a State in attempting to place upon a business extending into several States 'its fair share of the burden of taxation' is 'faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.' " *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942), quoting *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920). Because of this impossibility, "the States have wide latitude in the selection of apportionment formulas," *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 274, which need only result in a "*rough* approximation of a corporation's income that is *reasonably* related to the activities conducted within the taxing State." *Id.* at 273 (emphases added). The Constitution "is certainly not more exacting." *Butler Bros. v. McColgan*, 315 U.S. at 506. *See also Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266

from an apportionment formula because *that* income allegedly is not related to the corporation's presence in the taxing state is flatly inconsistent and irreconcilable with this Court's refusal to invalidate apportionment formulas or their application merely because they "will not produce a figure that represents the actual profits earned within the State" and, in fact, "will occasionally over-reflect or under-reflect income attributable to the taxing State." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 273.

Because the Constitution is not offended by "the substantial margin of error inherent in any method of attributing income among the components of a unitary business," *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 184, a corporation cannot have a constitutional right to remove any one type of income from its apportionable income base. It may be that a state's apportionment of a corporation's entire income will not have an exacting result with respect to business conducted in that state. But a similar "risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 278. In neither case does that mean that the resulting tax is grossly out of proportion to the business transacted in a state, *see Hans Rees' Sons, Inc. v. North Carolina*

U.S. 271 (1924). Therefore, a corporation is constitutionally entitled to show only "that the method of apportionment adopted by the state was inherently arbitrary," *Underwood*, 254 U.S. at 121 (footnote omitted), or that its application "led to a grossly distorted result." *Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. at 326. The Constitution does not mandate any more "precision in interstate taxation." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 278.

ex rel. Maxwell, 283 U.S. at 135, or that there is no " 'rational relationship' between the income attributed to the State by the apportionment formula and the intrastate value of the business." *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. at 226-27.

C. The Fair Apportionment Of All Income Of A Corporation Doing Business In A State Eliminates Tax Avoidance And Unnecessarily Complex Factual Inquiries.

Including all of a corporation's income in the apportionable income base thus creates no unconstitutional risk of distortion or extraterritorial taxation. Adjustments to the apportionment formula are the appropriate remedy for such concerns, which the taxpayer must prove by clear and cogent evidence. *See Trinova Corp. v. Michigan Dept. of Treasury*, 111 S.Ct. at 832. Conversely, allowing corporations to exclude income from that base creates a significant opportunity for—and greatly encourages—tax avoidance because it will "eliminate from the reach of the taxing power a large portion of the wealth of the country." *Adams Express Co. v. Ohio State Auditor*, 166 U.S. 185, 219 (1897).

"The first . . . component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the . . . business income being taxed." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 169. But this fairness works both ways. Excluding from the apportionable income base income such as capital gains or dividends reaped from investments in "discrete enterprises," *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. at 320, will result in less than all of a corporation's income being

taxed because many states where corporations have a business situs or commercial domicile apportion such income.[4] Prohibiting corporations from excluding that income from their apportionable base ensures that that income will not escape taxation, thus resulting in no more *and* no less than all business income being taxed. *See Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 169.

Including all income within the apportionable base also eliminates the need for state tax officials to unravel the complexities of multistate, multinational, multicorporate transactions and engage in the highly factual and often subjective inquiries that the unitary business principle requires. These complicated inquiries include ascertaining whether "there was centralization of management or achievement of other economies of scale," *F.W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. at 366, or "a highly integrated business which benefits from an umbrella

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[4] This Court "has recognized that 'the reason for a single place of taxation no longer obtains' when the taxpayer's activities with respect to intangible property involve relations with more than one jurisdiction," and that "cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails." *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. at 445 (citations omitted). Thus, "[s]ome States do not distinguish between business and nonbusiness income for apportionment purposes." *Moorman Manufacturing Co. v. Bair*, 437 U.S. at 279. Corporations with a business situs or commercial domicile in full apportionment states such as Maryland, *see* n. 2 *supra*, will thus escape taxation if the intangible income from a non-unitary source is held to be constitutionally immune from the tax on an apportioned basis. Such a result is particularly inappropriate given the Court's stated preference to avoid the "single place of taxation" concept.

of centralized management and controlled interaction," *ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. at 319, quoting *Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. at 224, or "some sharing of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation. . . ." *Container Corp. of America v. Franchise Tax Board*, 463 U.S. at 166.[5]

The only question that should be asked is whether a minimal connection or nexus exists between the corporation's interstate activities and the taxing state so that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *Wisconsin v. J.C. Penney Co.*, 311 U.S. at 444. If it does, there should be no constitutional obstacle to the fair apportionment of all income of that corporation.

CONCLUSION

For the reasons stated in the supplemental briefs of New Jersey and other *amici* who support Respondent, this Court should overrule *ASARCO* and *Woolworth*; reinstate the *Chevron Oil* test for determining whether a decision should apply retroactively; and apply its decision in this case retroactively. For the reasons set forth above, the following principles should govern the taxation of corporations doing busi-

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[5] The Herculean efforts which New Jersey was compelled to undertake to establish Bendix's history of acquisitions and the reasons therefor best illustrate these complexities. There is little benefit to a constitutional rule that virtually requires a corporation's chief executive officer to be deposed by every state that seeks to tax that corporation's income from intangibles.

ness in several states: the linchpin of apportionability in the field of state income taxation is the presence of constitutional nexus, *i.e.*, a minimal connection between the corporation's activities and the taxing state. If that nexus exists, all income of the corporation is subject to tax in that state on a fairly apportioned basis. Income is income, and the Constitution does not require different tests for taxing different types of income.

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